F I S C A L I M P A C T R E P O R T

ORIGINAL DATE 02/08/12
SPONSOR Sapien **LAST UPDATED** 02/14/12 **HB**

SHORT TITLE Manufacturing Product Gross Receipts **SB** 311/aSFC

ANALYST Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY12	**FY13**	**FY14**	**FY15**	**FY16**		
NFI	($4,500 - $7,500)	($9,351 - $15,585)	($9,743 - $16,240)	($10,065 - $16,776)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY12	FY13	FY14	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$0.0	($46.0)	($46.0)	($92.0)	Recurring	Taxation and Revenue Department

(Parenthesis ( ) Indicate Expenditure Decreases)

Conflicts with SB 276 and HB 256, Relates to HB 223, HB 184

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)
Updated to include response from Taxation and Revenue Department (TRD)
and Department of Finance and Administration (DFA)

SUMMARY

Synopsis of SFC Amendment

The Senate Finance Committee amendment provides a credit for tangible personal property to be consumed that has been purchased during a taxable year. This credit is no longer equal to the gross receipts tax, local option gross receipts taxes and compensating tax. The tax liability is now equal to six percent of the amount paid on consumables. The taxpayer must apply to the Economic and Development Department for a certificate of eligibility for the manufacturing consumption tax credit. The definition of “consumables” no longer applies to tools, dies or jigs.

Synopsis of Original Bill

Senate Bill 311 adds a new tax credit to the Corporate Income and Franchise Tax Act. Gross receipts or compensating tax on the purchase of tangible personal property consumed in the taxpayer's manufacturing process are eligible for credit. A credit equal to the gross receipts tax, local option gross receipts taxes and compensating tax paid on consumables used in the manufacturing process during the taxable year may be taken against the taxpayer's corporate income tax liability. "Consumables" is defined in the bill.

To be eligible for the tax credit a taxpayer must invest in capital equipment or facilities construction or renovation in New Mexico between January 1, 2012 and January 1, 2021 as follows: 1) at least $200 million over four years; 2) between $100 million and $200 million over three years; 3) between $50 million and $100 million over two years; and 4) between $10 million and $50 million for one year. Only one claim may be made at a time. A tax credit amount that exceeds the taxpayer's corporate income tax liability can be carried forward for four years.

The taxpayers may not claim other credits for the same investment pursuant to the Corporate Income and Franchise Tax Act, the Gross Receipts and Compensating Tax Act or the Investment Credit Act.

The purpose of the manufacturing consumption tax credit is to provide manufacturers in the state with an incentive that decreases the cost of production and promotes longevity, increased employment, retention and expansion of manufacturing businesses.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends or May 16, 2012.

The SFC Amendment removes the applicability end date. The applicability date of this bill is January 1, 2012 ~~to January 1, 2021 or 9 years~~. To be eligible the investment must still be made between January 1, 2012 and January 1, 2012.

FISCAL IMPLICATIONS

This bill may be counter to the LFC tax policy principle of adequacy. According to the LFC staff General Fund Recurring Appropriation Outlook for FY14 and FY15, December 2011 forecasted revenues will be insufficient to cover growing recurring appropriations.

The estimate assumes that companies will spend between $150 million and $250 million on consumables in the first year. The GRT yearly growth from the December 2011 Consensus Revenue Estimate has been applied to this estimate in the out years. As shown in the revenue table, six percent of the amount spent on consumables will be claimed as a credit on the taxpayers' corporate income tax return. The range allows for fluctuation on consumables expenditures. To estimate the tax base for the proposed deduction, the estimate relies on estimates of New Mexico capital expenditures from the 2007 Economic Census and 2010 Annual Manufacturers Survey. Intel alone spends between $150 million and $250 million a year on consumables.

The new investment will impact FY13 and beyond. There is a potential that this credit will attract more manufacturing businesses but the potential future revenue loss is not included. The potential revenue loss to the State from one company that invests $50 million in one year is $3 million.

TRD estimates the following:

Estimated Revenue Impact*					R or NR**	Fund(s) Affected
FY2012	**FY2013**	**FY2014**	**FY2015**	**FY2016**		
	(10,900)	(13,900)	(15,300)	(16,300)	R	General Fund, CIT

* In thousands of dollars. Parentheses ( ) indicate a revenue loss. ** Recurring (R) or Non-Recurring (NR).

Based on extensive analysis for HB-223 (which contains much of same impact as this bill), total eligible purchases of consumables will be $181 million for FY13, $232 million for FY14, $255 million for FY15 and $272 million for FY16. This will be distributed over time as follows:

Type of Investment	Eligibility Period	% of Total Purchases
Assume one annual investment in excess of 200 million	4 years	28%
One investment in excess of 100 million	3 years	17%
Two investments of 50 million	2 years	17%
Four investments of 10 million	1 year	11%
Ineligible		28%

Note: eligible investment only applies to section 179 property and facilities. For the 2012 tax year, Section 179 election is particularly beneficial for small business, allowing up to $139,000 in current year deduction for up to $560,000 in equipment. Over the $560,000 limit, section 179 allows a 50% bonus depreciation. This feature is available for any new equipment, no matter the size of the firm. Section 179 of the Internal Revenue Code allows an expense deduction for certain depreciable assets in the year of purchase, thus treating the asset as a consumable.

SIGNIFICANT ISSUES

According to a new Ernst & Young study released January 23, 2012 after incentives are included New Mexico still ranks poorly in some industries compared to eight other states but its rank improves for other industries when incentives are included. [1]

According to the TRD, reducing the tax burden on manufacturing inputs could increase the competitiveness of New Mexico manufacturing businesses relative to those of other states.

ADMINISTRATIVE IMPLICATIONS

The TRD and the EDD will be required to develop an application and claim form, instructions and process at a cost of $6,000. These forms will require a lot of data from the claimant. Determining eligible purchases will take time and may require regulation to identify in the instructions what can be included. The application and approval procedure will impose an administrative burden on the Economic Development Department and will, in the opinion of TRD staff, require annual approval and recertification, to be administered and processed effectively. TRD will have to develop audit procedures, and engage in Department employee and

[1] For more detail please refer to "New Mexico Business Tax Competitiveness and Simulations of Selected Tax Policy Changes" by Ernst & Young, January 23, 2012.

taxpayer education. The tracking will be complex since the 4 year carry forward cannot be applied during the term of allowed manufacturing consumption tax credit.

TECHNICAL ISSUES

According to the TRD, there is a policy issue embedded in this bill:

- As currently specified, only Section 179 property is included in calculating the amount of the investment, so that only the value of the facility and new equipment are included in the investment qualification. Equipment depreciable under other sections of the IRC would not contribute to the investment amount for the purpose of determining the credit duration.
- Likewise, the bill is silent whether "equipment" for the purpose of determining purchases subject to the 6% credit rate includes Section 179 property or not. Total Section 179 elections are limited and capped, so that generally, this provision of the IRC was intended to differentially benefit small business. However, if "equipment" for the purpose of the credit amount includes Section 179 property for all claimants, then the balance shifts back to larger investments.
- To resolve this issue, separate definitions of "equipment" for the purpose of the amount of the credit and "capital equipment" for the purpose of determining the amount of investment are recommended. If separate definitions are provided, "capital equipment" for the purpose of measuring the qualified investment could exclude section 179 property, while "equipment" for the purpose of measuring the base to which the 6% credit rate applies could include Section 179 property.
- The fiscal impact above assumes that Section 179 property is both included for determining the qualified investment and is also the operative definition of "equipment" for determining the base of the credit. If the suggestion in this technical note is implemented through amendment, the bill will have a somewhat smaller fiscal impact and, likely for a shorter duration than is currently stated.
- There is also a problem with referencing Section 179 of the IRC, since that section may change every year. It would be far preferable for certainty to embed permanent definitions in the bill itself, rather than legislate by reference to a section of the IRC that is not within the control of the State.

Note that wholesalers and other vendors could be negatively affected by this bill because they would continue to bear the liability of paying the gross receipts tax on the consumables. If prices were not adjusted, if the wholesaler failed to pass the tax forward, or if the manufacturer refused to pay the passed-forward tax, then at least some of the benefit this bill gives to manufacturers would be reduced by an additional burden on in-state vendors.

Regarding the definition of "consumables" under Paragraph J(2)(a), there is residual doubt about what constitutes consumable "equipment" for the purpose of calculating the base for the 6% credit rate.

One possible interpretation of this bill would allow the taxpayer to receive the credit for each year of the period as determined by Section 1, subsection D. If the duration is intended to apply only to the eligibility period or only to the investment period, this section should be clarified. The first interpretation could increase the impact almost fourfold by the fourth year.

From TRD:

Section 179 at a glance - New for 2012

2012 Deduction Limit = $139,000

This is good on new and used equipment, as well as off-the-shelf software.

2012 Limit on equipment purchases = $560,000

This is the maximum amount that can be spent on equipment before the Section 179 Deduction available to your company begins to be reduced.

Bonus Depreciation = 50%

This is taken after the $560k limit in capital equipment purchases is reached. Note: Bonus Depreciation is available for new equipment only. Bonus Depreciation can also be taken by businesses that will have net operating losses in 2012.

The above is an overall, "simplified" view of the Section 179 Deduction for 2012.

The picture above is an example of Section 179 at work:

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

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